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SUBJECT: BULGARIA: BIG U.S. INVESTORS DISCOVERING THAT  
REWARDS OUTWEIGH RISKS

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¶1. (SBU) SUMMARY: Bulgaria is seeing increased U.S. investment this year. Just during the week of June 5, three major American companies -- AES, General Electric and Hewlett Packard -- have broken ground or cut ribbons on projects bringing well over a billion dollars and thousands of jobs to Bulgaria. American investors, from portfolio to direct, continue to look at Bulgaria as one of the few "emerging markets" left in Europe. Paradoxically, at the same time investors, bankers and analysts agree the current government is less friendly and inviting to business than its predecessors. The process for getting up and running can be slow and difficult for anyone trying to work with the government on regulatory issues, to obtain licenses, or through privatizations or government contracts. But with proper due diligence American investors can benefit from this market, while at the same time their participation here will improve business practices and ethics. END SUMMARY

#### INCREASED PRESENCE OF U.S. BUSINESSES

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¶2. (SBU) The trend over the past several years of increased U.S. investment to Bulgaria has continued into 2006. With AES' launch of the largest foreign investment ever in Bulgaria, U.S. direct investment in 2006 alone will surpass the cumulative U.S. FDI from 1992 to 2005. The following three recently launched American investment projects show the breadth and quality of U.S. interests here:

--AES broke ground June 6 on a \$1.4 billion investment in a 670 MW lignite coal-fired electricity plant. This is the largest foreign investment ever in Bulgaria, and the largest energy project in South Eastern Europe.

--GE Real Estate has taken a 50 percent stake in one of the largest commercial projects in Sofia: a \$90 million, 33,500 square meter retail project. The ribbon cutting was held June 9th.

--HP announced the selection of Bulgaria from a field of 14 competing countries for their new Global Center for Customer Service. This will bring approximately 1,000 new information technology jobs to Sofia over the next two years.

¶3. (SBU) Bulgaria is presenting itself as an attractive destination for a diverse variety of U.S. investments. In addition to the three large activities that moved this week,

Tishman International is developing a 1.1 million square foot, \$84 million business park at the Sofia airport, and will break ground in September; Alcoa is planning to officially open their 200 person consumer products facility (USD 10 million) in September; and Pop-Weaver Popcorn will start their assembly line this summer. In addition, Microsoft plans to make an announcement in early July on an investment here, while hedge fund Grammercy Advisors is considering increasing its already considerable portfolio investments and diversifying into new direct ownership of several projects.

14. (U) Bulgaria's Foreign Direct Investment (FDI) statistics sharply underestimate the full picture of U.S. FDI. Many American investors establish subsidiaries in other European countries to manage their investments here as the U.S. and Bulgaria have not yet signed a double taxation treaty. Between 1992-2005, Bulgaria attracted USD 13 billion in FDI, according to the InvestBulgaria Agency (IBA). Official GOB statistics for 2005 rank the U.S. as 6th in terms of overall investment in Bulgaria at USD 594 million or 5 percent of total foreign investment. However, we calculate that number to be closer to USD 939 million, putting the U.S. in roughly 4th or 5th place.

PITFALLS . . .  
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15. (SBU) Even as foreign investors' interest in the vibrant Bulgarian market is surging, serious disincentives remain to be fixed. Investors, bankers, diplomats and even professional staff within the government have pointed out recently that the current Socialist-led government is less business friendly than its two center-right predecessors. Complaints revolve particularly around the difficulties foreign investors have in working with the government to obtain permits or licenses, on regulatory issues, and in privatizations or public procurement processes. There are

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also anecdotal reports of more blatant acts of public corruption in the business sphere. Investors directly dealing with private sector individuals also report occasional difficulties, but this appears to be at rates more commensurate with other European markets. In addition, one career civil servant has mentioned to us that non-Russian foreign investors seem to be disadvantaged in the current administration.

16. (SBU) Other difficulties for foreign investors include Bulgaria's low labor productivity, energy inefficiency and low Internet penetration. Some of the other key impediments to investment in Bulgaria are:

- Bureaucratic delays, including the need for numerous licenses, and onerous permit processes;
- Perception of petty and high-level corruption by authorizing officials in tenders, licenses and permit procedures;
- Practice of government/judiciary or other officials reviewing contacts already signed;
- Ineffective rule of law, especially in the judicial system, means investors do not have adequate recourse to the court system for enforcement of contracts, intellectual property rights, and judicial decisions;
- Insufficient development of financial intermediation adversely affects access to credit, especially for small and medium businesses;
- Infrastructure needs massive upgrading, especially roads, railroads and ports;
- Low wages, although attractive as a low cost of labor, mean consumer purchasing power is low; and
- Lack of strong project managers.

. . . BUT ALSO CLEAR POTENTIAL  
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17. (SBU) Despite these drawbacks, business opportunities are increasing and the outlook for further FDI inflows remains encouraging. First quarter 2006 FDI is estimated at Euro 755 million - a healthy amount for this small economy. The prospect of Bulgarian membership in the EU continues to attract foreign firms as it leads to regulatory improvement and legislative reform. Bulgaria has great FDI potential as a manufacturing platform for export to the EU based on its relatively cheap, but skilled, work force. And a recent survey showed growth potential in several areas: services, apparel production, banking, the food and beverage industry, pharmaceuticals, steel production, and retail trade. But with privatization coming to an end, the pool of inexpensive talent running dry, and the challenge of increased competition from other FDI destinations, the GOB needs to increase efforts to improve the investment climate with the goal of attracting even more global investors.

#### A CASE IN POINT

18. (SBU) The saga of the U.S. film company NuImage's battle to purchase and privatize the government's film studio is an example of how tedious, but potentially rewarding, it can be to do business here. It has been over a year since the Privatization Agency decided NuImage's offer to privatize the studio was the best of the three contenders, and almost ten months since the government and the company signed the contract. Constant "moving the goal posts" by various government players involved has delayed the finalization of the project, and added to concerns that Bulgaria is a difficult place to complete a deal. Without active and aggressive advocacy by the Embassy in this case - and for AES - none of the projects would have gotten as far as they have. Despite the difficulties, however, NuImage continues to insist this is the deal and the place for them to develop their studio, indicating that the eventual return on their investment here will far outweigh the problems they have incurred so far.

#### COMMENT

19. (SBU) Looking at the FDI trends, other investors clearly agree with the NuImage risk-benefit calculation. We are seeing a noticeable upswing of interest in Bulgaria from U.S. investors. Some projects are coming to fruition after years of negotiations, while others seem to pop up like mushrooms after the rain. We are encouraged by the

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increasing presence of American businesspeople here, who we feel will help both of our economies and transfer much-needed American-style business practices and know-how to this emerging market. As long as investors arrive with eyes wide open and undertake sufficient due-diligence as to their partners and the overall environment, we say "keep `em coming." Increased American investment will help raise the level of business standards and ethics at the market level, and strengthen the Embassy's hand in lobbying the government for systemic change that can marginalize the shady operators' advantage here.

BEYRLE